INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	3
Argument	6
Conclusion	11
Appendix	12

CITATIONS

Cases:

Better Business Bureau v. *United States*, 326 U. S. 279	7
Biddle v. *Commissioner*, 302 U. S. 573	10
Chattanooga Automobile Club v. *Commissioner*, 12 T. C. 967	7
Helvering v. *N. Y. Trust Co.*, 292 U. S. 455	10
Higgins v. *Commissioner*, 312 U. S. 212	10
Keystone Automobile Club v. *Commissioner*, 12 T. C. 1038	7

Statute:

Internal Revenue Code, Sec. 101 (26 U.S.C. 1946 ed., Sec. 101)	2, 6, 7, 9

Miscellaneous:

G.C.M. 23688, 1943 Cum. Bull. 283	10, 15
6 Mertens, Law of Federal Income Taxation, Sec. 34.30	10
Rules of Civil Procedure, Rule 52	9
Treasury Regulations 33, Art. 72	12
Treasury Regulations 45, Art. 520	12
Treasury Regulations 62, Art. 520	13
Treasury Regulations 65, Art. 520	13
Treasury Regulations 69, Art. 520	13
Treasury Regulations 74, Art. 530	13
Treasury Regulations 77, Art. 530	14
Treasury Regulations 86, Art. 101(9)-1	14
Treasury Regulations 94, Art. 101(9)-1	14
Treasury Regulations 101, Art. 101(9)-1	15
Treasury Regulations 103, Sec. 19.101(9)-1	15
Treasury Regulations 111, Sec. 29.101(9)-1	2, 15

In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 444

CALIFORNIA STATE AUTOMOBILE ASSOCIATION, A CORPORATION, PETITIONER

v.

JAMES G. SMYTH, COLLECTOR OF INTERNAL REVENUE OF THE FIRST INTERNAL REVENUE COLLECTION DISTRICT OF CALIFORNIA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 67-78) is reported at 77 F. Supp. 131. The opinion of the Court of Appeals (R. 226-234) is reported at 175 F. 2d 752.

JURISDICTION

The judgment of the Court of Appeals was entered on June 22, 1949. (R. 234-235.) A petition

for rehearing was denied on August 8, 1949. (R. 235.) The petition for a writ of certiorari was filed on November 4, 1949. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether the taxpayer was, during the taxable years 1943 and 1944, a club organized and operated exclusively for pleasure, recreation and other nonprofitable purposes within the meaning of Section 101 (9) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

> SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.
>
> The following organizations shall be exempt from taxation under this chapter—
>
> * * * * *
>
> (9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder;
>
> * * * * *
>
> (26 U. S. C. 1946 ed., Sec. 101.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

> Sec. 29.101(9)-1. *Social clubs.* The exemption granted by section 101(9) applies to prac-

tically all social and recreation clubs which are supported by membership fees, dues, and assessments. If a club engages in traffic, in agriculture or horticulture, or in the sale of real estate, timber, etc., for profit, such club is not organized and operated exclusively for pleasure, recreation, or social purposes. Generally, an incidental sale of property will not deprive the club of the exemption.

STATEMENT

Taxpayer was organized under the laws of California in 1907 as a nonprofit corporation, the purposes of which the District Court found to be as follows (R. 82):

> (1) To promote and encourage highway construction, improvement, betterment, maintenance and marking for the guidance and warning of the users.
>
> (2) To urge adoption of just and intelligent legislation on the use of highways and the regulation of traffic thereon.
>
> (3) To maintain offices for collecting and disseminating information and the furnishing of advice and assistance to the owners of automobiles.
>
> (4) To protect the legitimate interests of its members in connection with its purposes.
>
> (5) To affiliate and associate with similar organizations.

The District Court also found (R. 83-84) that taxpayer, in furtherance of its purposes, "provided" during 1943 and 1944 the following:

> (1) A Touring Bureau which provides the members with complete touring data and assists them in planning motor trips.
>
> (2) An Emergency Road Service Department, which makes arrangements for the rendering of emergency road service to members who encounter automobile trouble on the highways, which service is restricted to passenger cars.
>
> (3) A Road Sign Department, which operates in conjunction with state and local authorities, a service consisting of the erection and maintenance of direction and warning signs and historical markers.
>
> (4) A Public Safety Department, which carries on an active and aggressive campaign to reduce traffic accidents, eliminate traffic hazards and generally improve traffic conditions.
>
> (5) An Adjustment and Traffic Department, which advises and assists the members with respect to traffic violations and accidents.
>
> (6) A License Department, which assists members in the annual renewal of automobile registration with the State Department of Motor Vehicles and obtaining automobile license plates, as well as Federal auto tax stamps.

(7) A Magazine Department which publishes and distributes free to the members a magazine, keeping them informed of motoring conditions and improvements, and specializing in travel information with respect to trips to points of interest where members will find pleasure and recreation, and which has contained no paid advertising material since January 1, 1942.

The Articles of incorporation as amended in 1929 provide in the third paragraph of Article II as follows (R. 227-228):

> That the purposes for which said corporation is formed are: . . .
>
> To furnish advice, information and assistance of all kinds to owners and operators of self-propelled vehicles of all kinds operated on land or sea or in the air and to establish and maintain offices, agencies and bureaus in said State and elsewhere for the purpose of collecting and disseminating such information and rendering such service . . .

Articles II and III of the by-laws are as follows (R. 228):

Article II

Purposes and Powers

> Section 1. The purposes and powers of this Association shall be those which are set forth in the Articles of Incorporation as now existing or as the same may be hereafter amended.

Article III

Membership

Section 1. All persons interested in the objects of this Association as hereinabove set forth shall be eligible to membership.

Section 2. Similar Associations interested in the objects of this Association shall be eligible to membership.

Among the services rendered by taxpayer to its members, according to the testimony of taxpayer's officers, were tow service, emergency road service, map service, bail bond service, touring service, claim adjustment service, license service, and also a limited personal accident service insurance policy. (R. 144.) An additional privilege of membership was the right to obtain automobile insurance at cost. (R. 126-127, 140-141.)

The District Court concluded (R. 87) that the "association is and was at all times here pertinent a club within the meaning of Section 101 (9) of the Internal Revenue Code" and that taxpayer (R. 89) "was organized and operated exclusively for pleasure, recreation and other nonprofitable purposes during the years 1943 and 1944". The judgment was reversed by the Court of Appeals. (R. 235.)

ARGUMENT

In denying taxpayer a tax exempt status under Section 101 (9) of the Code, *supra*, the Court of

Appeals reached the only conclusion compatible with the language of the statute;[1] and since the decision involves no conflict with any other case the petition for certiorari should be denied.

Section 101 (9) of the Code grants tax exempt status to—

> Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder;
>
> * * * * *

The undisputed facts disclose that taxpayer is not a "club" as that term is used in the statute, and that it was neither organized nor operated exclusively for pleasure and recreation.[2] That the

---

[1] The Tax Court has reached the same conclusion as to organizations similar to the petitioner in *Keystone Automobile Club* v. *Commissioner*, 12 T. C. 1038, pending on appeal in the Court of Appeals for the Third Circuit, and in *Chattanooga Automobile Club* v. *Commissioner*, 12 T. C. 967, pending on appeal in the Sixth Circuit.

[2] On the familiar doctrine of *ejusdem generis* the test of exemption is whether a club is organized and operated exclusively for pleasure, recreation and other *similar* nonprofitable purposes. Any other interpretation would render meaningless the word "exclusively" preceding "pleasure, recreation". See *Better Business Bureau* v. *United States*, 326 U. S. 279, 283. An analysis of all the subsections of Section 101 demonstrates that only those nonprofit organizations which meet the functional requirements enunciated were intended to be tax exempt. Finally the Regulations dealing with Section 101 (9) (Appendix, *infra*), which have been in effect since 1916, are all entitled "Social clubs" and all contain the following or similar phrase: "The exemption granted by section 101 (9) applies to all social and recreation clubs * * *".

taxpayer is not a club is manifested by the facts that there was no provision made for social intercourse; that there was no real commingling of the bulk of the membership; that the membership was substantially unlimited; and there were no club activities. (R. 133, 135-137.) In essence taxpayer is a service association organized and operated to render services to its members for a fee and to obtain such other objectives as the betterment of highway construction and the promotion of safe driving. It is patent that when, for the payment of $12, the so-called "member" secured the right to tow service, emergency road service, bail bond service, claim adjustment service, plus a personal accident policy, and the privilege of purchasing automobile insurance at cost, the "member" was not joining a club but was purchasing services. (R. 126-127, 140-141, 144.)

Moreover, taxpayer is neither organized nor operated exclusively for pleasure and recreation. As the Court of Appeals observed (R. 227-228), the articles of incorporation as amended provide *inter alia* that the purpose of the organization is to furnish advice, information and assistance to owners and operators of *"self-propelled vehicles of all kinds"*, and the by-laws provide for membership of all persons interested in the organization's objectives, which would include owners and operators of commercial vehicles. While it is true that owners of trucks and purely commercial vehicles were

not in fact admitted to membership, all owners of passenger cars driven by capable drivers were admitted. Since no argument is required to demonstrate that the passenger car is itself commonly utilized by commercial agents and is regularly employed in the conduct of ordinary daily business, it is thus apparent that taxpayer is not operated exclusively for pleasure and recreation. Indeed, during the taxable years much of taxpayer's activity was concerned with the war effort. (R. 121-123.) Consequently taxpayer can meet none of the tests enunciated by the statute for exempt status.

Taxpayer's suggestion (Pet. 9) that the Court of Appeals failed to give effect to Rule 52(a) of the Rules of Civil Procedure is without merit. No bona fide dispute exists as to the nature of the California State Automobile Association or its activities; nor was the credibility of witnesses in any way involved. The question presented to the Court of Appeals was one of statutory construction; and the court interpreted the statute correctly. It is in any case clear that the District Court committed error in holding that the taxpayer was a "club[s] organized and operated exclusively for pleasure, recreation and other nonprofitable purposes" within the meaning of Section 101 (9).

Similarly without merit is taxpayer's contention that the Court of Appeals was bound to give effect to early informal administrative rulings. Such

rulings lack the dignity and effect of Treasury Regulations; are binding on neither the Commissioner nor the taxpayers; and, being principally of individual application, do not, when followed by reenactment of the statute, imply Congressional acquiescence. *Helvering* v. *N. Y. Trust Co.,* 292 U. S. 455; *Biddle* v. *Commissioner,* 302 U. S. 573; *Higgins* v. *Commissioner,* 312 U. S. 212. Moreover in 1943, the earlier rulings here relied upon by taxpayer were thoroughly reviewed and it was concluded that organizations such as the taxpayer are not entitled to exempt status under Section 101 (9). G.C.M. 23688, 1943 Cum. Bull. 283[3] (Appendix, *infra*). Finally, the Regulations, while they do not deal specifically with automobile associations, fully support the Collector's position here.[4]

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[3] This ruling is characterized by Mertens as "an extended and well considered opinion". 6 Mertens, Law of Federal Income Taxation, Sec. 34.30, p. 63.

[4] See fn. 2.

CONCLUSION

The decision of the Court of Appeals is correct, turns on the particular facts of the case and is not in conflict with any other decision. The petition should therefore be denied.

Respectfully submitted,

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DECEMBER, 1949.

APPENDIX

Treasury Regulations 33 (Revised), promulgated under the Act of September 8, 1916, as amended by the Act of October 3, 1917:

> Art. 72. *Social clubs.*—Social clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes are exempt from tax, provided no part of any net income which they receive inures to the benefit of any private stockholder or individual. This exemption will reach practically all social and recreation clubs which are supported by membership fees, dues, and assessments.
>
> If a club, by reason of the comprehensive powers granted in its charter, engages in traffic, in agriculture, or horticulture, in the sale of real estate, timber, etc., for profit, it will be held that such club is not organized and operated exclusively for pleasure, recreation, or social purposes. It thus becomes a business or commercial enterprise, and any profit realized from such activities is subject to the tax imposed by this title, and the club so operated must make returns of annual net income.

Treasury Regulations 45, promulgated under the Revenue Act of 1918:

> Art. 520. *Social clubs.*—The exemption applies to practically all social and recreation clubs which are supported by membership fees, dues and assessments. If a club, by reason of the comprehensive powers granted in its charter, engages in traffic, in agriculture

or horticulture, or in the sale of real estate, timber, etc., for profit, such club is not organized and operated exclusively for pleasure, recreation or social purposes, and any profit realized from such activities is subject to tax.

Article 520 of Treasury Regulations 62, promulgated under the Revenue Act of 1921, is the same as the same numbered Article of Regulations 45.

Treasury Regulations 65, promulgated under the Revenue Act of 1924:

> Art. 520. *Social clubs.* — The exemption granted by paragraph (9) of section 231 applies to practically all social and recreation clubs which are supported by membership fees, dues, and assessments. If a club, by reason of the comprehensive powers granted in its charter, engages in traffic, in agriculture or horticulture, or in the sale of real estate, timber, etc., for profit, such club is not organized and operated exclusively for pleasure, recreation, or social purposes, and any profit realized from such activities is subject to tax.

Article 520 of Treasury Regulations 69, promulgated under the Revenue Act of 1926, is the same as the same numbered Article of Regulations 65.

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

> Art. 530. *Social clubs.* — The exemption granted by section 103 (9) applies to practically all social and recreation clubs which are supported by membership fees, dues, and as-

sessments. If a club, by reason of the comprehensive powers granted in its charter, engages in traffic, in agriculture or horticulture, or in the sale of real estate, timber, etc., for profit, such club is not organized and operated exclusively for pleasure, recreation, or social purposes, and any profit realized from such activities is subject to tax.

Article 530 of Treasury Regulations 77, promulgated under the Revenue Act of 1932, is the same as the same numbered Article of Regulations 74.

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

> Art. 101(9)-1. *Social clubs.*—The exemption granted by section 101 (9) applies to practically all social and recreation clubs which are supported by membership fees, dues, and assessments. If a club, by reason of the comprehensive powers granted in its charter, engages in traffic, in agriculture or horticulture, or in the sale of real estate, timber, etc., for profit, such club is not organized and operated exclusively for pleasure, recreation, or social purposes, and any profit realized from such activities is subject to tax. If a club, otherwise exempt, sells any of its property at a profit, it is not exempt for the taxable year for which the profit is taxable.

Article 101(9)-1 of Treasury Regulations 94, promulgated under the Revenue Act of 1936, is the same as the same numbered Article of Regulations 86.

Treasury Regulations 101, promulgated under the Revenue Act of 1938:

> Art. 101(9)-1. *Social clubs.*—The exemption granted by section 101(9) applies to practically all social and recreation clubs which are supported by membership fees, dues, and assessments. If a club engages in traffic, in agriculture or horticulture, or in the sale of real estate, timber, etc., for profit, such club is not organized and operated exclusively for pleasure, recreation, or social purposes. Generally, an incidental sale of property will not deprive the club of the exemption.

Sections 19.101(9)-1 of Treasury Regulations 103 and 29.101(9)-1 of Regulations 111, promulgated under the Internal Revenue Code, are the same as Article 101(9)-1 of Regulations 101.

G. C. M. 23688, 1943 Cum. Bull. 283:

* * * * *

> (b) Even if the individuals who are members of "clubs" or "divisions" were also members of the association, it is believed that the organization would not qualify as a "club" within the meaning of the statute. Although there is no statutory definition of the term "club," as used in section 101(9) of the Code, it is believed that the term contemplates a comingling of members, one with the other, in fellowship. Thus, an organization should be so composed and its activities be such that fellowship among the members plays a material part in the life of the organization in order

for it to come within the meaning of the term "club." Social activities among the members of the component parts of the instant organization are confined to small, random groups. No material group activity of any kind is carried on or sponsored by the association or any of its component parts, and it does not appear that there are any facilities for personal contacts among the members. It is represented that the "club" or "division" headquarters may be considered the "clubhouse" of each individual. While a clubhouse is not considered essential to the existence of a club, it does not appear that the headquarters, where practically the only activity is that of keeping records and dispensing personal information, would constitute a clubhouse in any real sense of the word. As the principal activity of the organization, with respect to the members of its component parts, is that of rendering personalized services in connection with the use of their automobiles, in the receipt of which each individual participates without contact with, or regard for, any other member, it does not appear that fellowship constitutes a material part of the life of the organization. It it to be noted, however, that fellowship need not be present between each member and every other member of a club, if it constitutes a material part of the life of the organization. In this respect, it is believed that a State-wide or Nation-wide organization, which is made up of individuals, but is broken up into local groups, satisfies this requirement if fellowship

constitutes a material part of the life of each local group.

The term "clubs," as used in section 101(9) of the Code, supra, is used in the same sense as the term "club" is used in section 1710 of the Code and corresponding sections of the Revenue Acts relating to the taxation of dues or membership fees paid to "any social, athletic, or sporting club or organization." (See G.C.M. 13067, supra.)

In *Arner* v. *Rogan* (May 20, 1940, unreported), the District Court of the United States for the Southern District of California, Central Division, had occasion to consider whether the Biltmore Health Club was a "club" within the meaning of section 501 of the Revenue Act of 1926, as amended by section 413(a) of the Revenue Act of 1928 (now section 1710 of the Code). In concluding that the organization was not a club, the court said:

> * * * at least there must be some sort of association or cooperation between the members in an effort to reach some common objective before we may consider that there is a club or organization.

In the course of its opinion, the court observed:

> The evidence shows that members never met together or in committee and never participated in any activities which are normally carried on by members of clubs or similar organizations, nor is there evidence that the patrons were entitled by the terms of their contracts to so participate. * * *

Another factor given weight by the court was that:

> * * * the Biltmore Health Club did not in practice restrict its membership, nor did it agree to do so. The only qualifications apparently were that the applicant be over 21, white, free from any contagious disease or dangerous physical condition, and able to pay the fees.

The necessary implication to be derived from the Arner case is that financial contribution by way of a fee charged by the organization does not amount to "association or cooperation between the members in an effort to reach some common objective," but that there must be some participation by the members in activities ordinarily carried on by clubs, which activities are intended to culminate in the realization of a common objective.

The evidence in the instant case does not indicate that members of the M Association participate in activities normally carried on by members of a club. Generally, the activities of the association may be classed in two groups, namely, those relating to the promotion of highway and motoring improvements and those relating to the services offered to individuals. In so far as the promotion of highway and motoring improvements is concerned, it does not appear that any substantial part of the local membership of the organization participates in such activities. Individual members, as such, have no right to vote or participate in the affairs of the corporation. The by-laws restrict voting rights to member organizations. In so far as services to individuals are concerned, members participate

only to the extent of receiving such services. Although it might be contended that the receiving of services constitutes a common objective of the local members, it can not be said that members participate in activities leading to the rendition of such services, except to the extent that they make a financial contribution by way of a fee charged by the local organization. The principal activity of the M Association with respect to individuals, as stated above, is that of rendering services to motorists. Printed matter used in the solicitation of new members emphasizes the protection, service, and savings that accrue to members. It is reasonable to presume, then, that the actuating motive of individuals in joining the organization is to secure the convenience and savings afforded by services offered by the organization, and not to participate in any common objective proposed by the executives of the organization.

Although it should not be taken as the sole criterion, it is to be noted that no limitations are placed on membership by individuals. Organization members are limited to the extent that two franchises will not be given for the same territory. As to individuals, the organization is open to anyone who has not been convicted of manslaughter, negligent homicide, or hit-and-run or drunken driving, and who can pay the annual fee.

Upon reconsideration of the issue on the basis of the facts now presented, it is the opinion of this office that the M Association is not a "club," within the meaning of section 101(9) of the Internal Revenue Code and corresponding provisions of prior Revenue Acts.

Even though the association qualified as a "club" within the meaning of the statutes, it is not believed that it would be entitled to exemption as a club "organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes."

It is well recognized that exemption provisions, such as section 101(9) of the Code, supra, are to be strictly construed. In *Chicago Theological Seminary* v. *Illinois* (188 U.S. 662), the Supreme Court of the United States stated in part as follows:

> The rule is that, in claims for exemption from taxation under legislative authority, the exemption must be plainly and unmistakably granted; it can not exist by implication only; a doubt is fatal to the claim.

Under the rule of *noscitur a sociis,* the test of exemption is whether a club is organized and operated exclusively for pleasure, recreation, and other *similar* nonprofitable purposes. It appears, then, that section 101 (9) of the Code, supra, contemplates a club which devotes itself *exclusively* to activities in the nature of pleasure and/or recreation.

The principal activity of the M Association is that of rendering services to members in connection with the repair, maintenance, and use of their automobiles. In such respect, the organization operates in the nature of a nonprofit cooperative buying association. From the standpoint of the pleasure and recreation to be derived from the use of an automobile, most of the services offered are of the type available to motorists generally on a com-

mercial scale at greater cost. Upon the payment of an annual fee, a member becomes entitled to free emergency road services which include such things as 30-minute road repairs, towage, tire changing, and gasoline delivery. In addition thereto, free services include brake and headlight adjustments, protection from car theft, and bail bond service. Insurance coverage is furnished at reduced premium costs, and members are able to make certain purchases at less than market price. In view of the above, it appears that the association operates to a material extent as a service club and is not engaged *exclusively* in activities in the nature of pleasure and/or recreation within the meaning of the statute.

It is not believed that section 101(9) of the Code, supra, was intended to exclude from Federal income taxation a club wherein the principal activity is that of rendering services of a commercial nature to members at a lower cost than would be paid elsewhere, even though the club derives no profits from such activity.

In view of the foregoing discussion and conclusions, G.C.M. 3555, supra, and G.C.M. 2867 (C.B. VII-1, 115 (1928)) are revoked, and it is recommended that O.D. 643 (C.B. 3, 241 (1920)) be revoked and that I.T. 2106 (C.B. III-2, 228 (1924)) be modified to conform to the views expressed in this opinion.

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